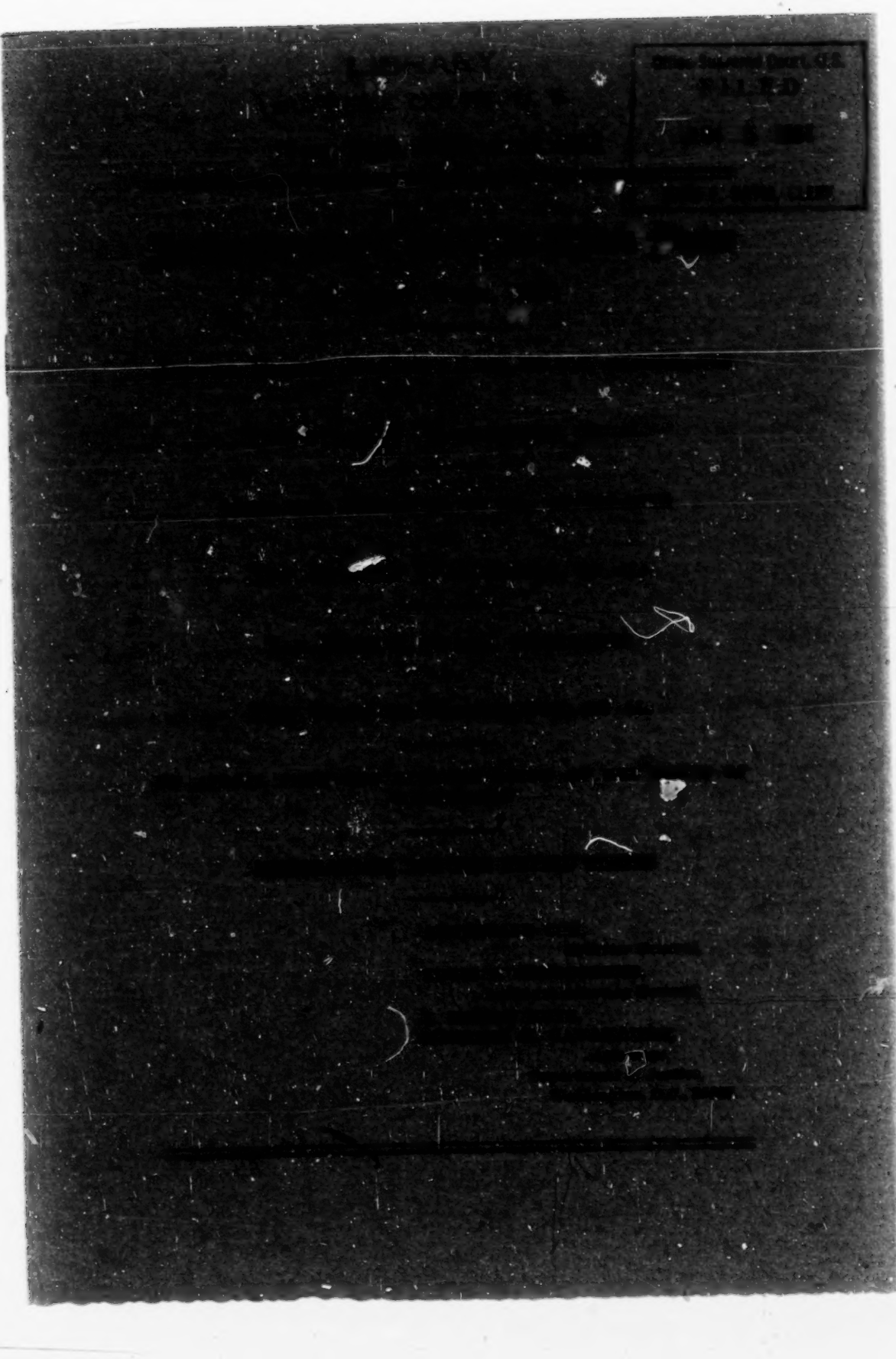

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 849

INLAND EMPIRE BUILDERS, INC., ET AL., APPELLANTS

v.

THE STATE OF WASHINGTON, ET AL.

No. 850

HEBB AND NARODICK, ET AL., APPELLANTS

v.

THE STATE OF WASHINGTON, ET AL.

No. 851

IAN MURRAY, ET AL., APPELLANTS

v.

THE STATE OF WASHINGTON, ET AL.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF WASHINGTON

MEMORANDUM FOR THE UNITED STATES

This memorandum is filed in response to the order of this Court, dated May 4, 1964, inviting the Solicitor General to express the views of the United States.

733-387—64

1. In order to provide government-owned military housing as expeditiously as possible and without including the full costs of construction in the current budget, in 1955 Congress passed the Capehart Act (69 Stat. 646, *et. seq.*), authorizing a method of financing military housing through private lending facilities. See S. Rep. No. 231, 85th Cong., 1st Sess., p. 26, *et. seq.* The heart of the system is simple and involves only three parties: the United States, the contractor, and the lending institution which finances the construction. The contractor is paid an amount agreed upon with the government for building to the government's specifications. This amount is advanced by the lending institution which is, in turn, repaid by the government.

Neither the contractor nor the lending institution has any interest in the further refinements and complications which are superimposed on this basic framework solely for governmental purposes. The government requires the contractor to create a fourth party—a corporation whose stock is initially issued to the contractor, then placed in escrow for the United States. This "mortgagor-builder corporation" signs a note as primary debtor on a federally guaranteed loan from the lending institution (although the government, and not the corporation, repays the loan) and makes payments to the contractor from the funds advanced by the lending institution (although payments can only be made at the direction of the government). The corporation acquires nothing for the funds it disburses and cannot profit from its services.

The question presented by these cases is whether the mortgagor-builder corporation, which is created and used solely for government purposes, is subject to a State sales tax. The basic constitutional and statutory framework is clear. The Washington sales tax, as authoritatively construed by the State court, is imposed upon the purchaser of constructed housing property.[1] A sales tax cannot constitutionally be imposed on the United States or its instrumentalities. *Kern-Limerick, Inc.* v. *Scurlock*, 347 U.S. 110. Whether the purchaser of the housing was the United States or its instrumentality is a question of federal law, reviewable by this Court on appeal. *Id.* at 121, 122. The Supreme Court of Washington held that the State tax is applicable to Capehart housing on the grounds that the mortgagor-builder corporation, not the United States, is the purchaser of this housing and that the corporation is not the agent or instrumentality of the United States.

2. The procedures for the financing and construction of Capehart housing are set forth in detail in the Jurisdictional Statements filed by the appellants in the present cases. See, in particular, Jurisdictional Statement in No. 850, pages 5–19. We therefore believe it is sufficient to summarize the ultimate legal consequences of the transactions which take place whenever such housing is constructed. These conse-

[1] Revised Code of Washington, §§ 82.08.020, 82.04.050. Since the tax can be collected from the seller-contractor when the buyer does not pay (§ 82.08.050), the State has assessed the tax against the contractors in the present case and they are the parties to this proceeding.

quences establish that Capehart housing is purchased by the United States through the medium of the mortgagor-builder corporation.

A. As noted above, the substance of a Capehart transaction is governmental acquisition of military housing by payment to a contractor of amounts initially advanced by a lending institution and then repaid to the lending institution by the United States. Like any purchaser the United States specifies the property it wishes constructed (Exs. 1 and 2). Indeed, it solicits and accepts bids before the mortgagor-builder corporation is even created (Ex. 3). The United States alone may accept or reject the construction work as it is done (Ex. 8, Articles XVIII and XV); and the United States can modify the terms of construction without the consent of the mortgagor-builder corporation (Ex. 8, General Provisions, par. 9). The government obtains from the contractor title and the right to possession of the housing; there is no time when the mortgagor-builder corporation owns or has the right to use the housing which the State has said it purchased (Ex. 6, pp. 1–2; Ex. 8, General Provisions, par. 14(c), and Article XIV). The funds used to pay the contractor are advanced by a lending institution on the strength of the government's credit; the corporation which signs the note as primary debtor has neither assets nor any prospect of obtaining assets and is thus without credit. The funds advanced are, pursuant to contract, repaid to the lender by the United States; it is never contemplated that they will be repaid by the corporation (Ex. 16, par. 2; Ex. 1, p. 1). The

United States has been held liable to the contractor for cancellation of the construction contract. See *G. L. Christian and Associates* v. *United States*, 312 F. 2d 418 (Ct. Cl.).

B. These facts establish that the United States, not the mortgagor-builder corporation, is the purchaser of Capehart housing. This conclusion is confirmed by additional evidence showing that the corporation is an almost empty shell, organized at the government's insistence and according to government-prescribed forms solely for government purposes (Ex. 4). It is, in short, a government instrumentality. The corporation has no real assets, no liabilities, and no authority to engage in business for its own profit. Its original paid-in capital of $1,000 is paid over to the government prior to construction in exchange for a 55-year leasehold under which the lessee has no rights of use or possession (Exs. 4 and 7). Its obligations and liabilities are all assumed and guaranteed either by the United States or the contractor (Ex. 8, Articles V, XXI, XXII). The corporation serves no private role. Neither the lending institution, which loans money on government credit and is repaid directly by the government, nor the contractor, which performs construction work for these amounts, benefits from the use of the corporate intermediary to sign a note and disburse the funds. The corporation itself receives no income and cannot possibly profit from the transaction (Ex. 1, p. 2, par. 1(e)).

The articles of incorporation restrict the functions of the corporation to performance of the Capehart

transaction (Ex. 4). The contract and lease, in turn, narrow the corporation's rights and responsibilities to those necessary for government purposes. It cannot accept or reject the work for which it disburses funds (Ex. 8, Articles IV and XVIII); it does not obtain title to or rights to use of the property (Ex. 6, p. 1; Ex. 8, General Provisions par. 14(c), and Article XIV); it cannot disburse funds except at the direction of the United States (Ex. 8, Article IV). Finally, these provisions are enforced by an escrow agreement under which, at all relevant times, the corporate stock and the signed resignations of the directors are irrevocably placed beyond the contractor's control and can be obtained by the United States by terminating performance of the construction for the convenience of the government (Ex. 11, p. 2).

3. Since, in our view, the Supreme Court of Washington erred in upholding the constitutionality of the State sales tax as applied to these purchases of Capehart housing by the United States, we think that these appeals present a substantial federal question. The highest courts of several other States have disagreed upon the issues.[6] Compare *Knapp-Stiles, Inc. v. Dept. of Revenue*, 370 Mich. 629, 122 N.W. 2d 642, with *Silberblatt, Inc. v. Tax Commission*, 5 N.Y. 2d 635, 159 N.E. 2d 195, certiorari denied, 361 U.S. 912;

[6] At the request of this Court (361 U.S. 892), the Solicitor General filed a brief in the *Silberblatt* case setting forth his views that the importance of the issues presented warranted issuance of the writ of certiorari.

see also *Green* v. *Eglin AFB Housing, Inc.*, 104 So. 2d 463, 467 (D.C. App. Fla.).

On the other hand, the question does not appear to have great continuing importance. New construction under the Capehart housing program is now coming to an end. Pursuant to Section 803(a) of the National Housing Act, as amended, 12 U.S.C. (Supp. IV) 1748b(a), no mortgages have been insured by the Federal Housing Commission under the Capehart Act since October 1, 1962. The major importance of the decision below is, therefore, that it subjects a useful form of private financing of government purchases to the undue threat of State taxation. If a method of financing similar to the Capehart device is used again in the future, as well it may be, the decision below and the disposition of the cases in this Court will stand as precedents defining the consequences of its use.

Since the questions presented by these appeals cannot be dismissed as insubstantial, it would seem that probable jurisdiction should be noted.

Respectfully submitted.,

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[1] The United States has no direct financial interest in the present litigation. It is not obligated to reimburse the contractors for taxes they are required to pay.

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263 U.S. 341, 68 L.ed. 328, 44 Supreme Court 121, and followed in *United States v. Livingstone*, 179 F.Supp. 9; aff'd 364 U.S. 281, 4 L.ed.(2d) 1719, will be virtually destroyed. These cases cannot be reconciled with the majority decision in the present case.

We therefore submit that the Motion to Dismiss should be denied and these cases be set for full hearing on the merits.

Respectfully submitted,

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Dated April 17, 1964.